IPG Photonics Corporation
Second Quarter 2022 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' second quarter 2022 conference call. Today's call is being recorded and webcast. At this time, I would like to turn the call over to Eugene Fedotoff, IPG's Director of Investor Relations, for introductions. Please go ahead sir.

Eugene Fedotoff:

Thank you operator, and good morning everyone. With us today is IPG Photonics' CEO, Dr. Eugene Scherbakov and Senior Vice President and CFO, Tim Mammen. Statements made during the course of this call that discuss management's or the company's intentions, expectations or predictions of the future are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause the company's actual results to differ materially from those projected in such forward-looking statements. These risks and uncertainties are detailed in IPG Photonics' Form 10-K for the period ended December 31, 2021 and other reports on file with the Securities and Exchange Commission. Copies of these filings may be obtained by visiting the Investors section of IPG's website or by contacting the company directly. You may also find copies on the SEC's website.

Any forward-looking statements made on this call are the company's expectations or predictions as of today, August 2, 2022, only. The company assumes no obligation to publicly release any updates or revisions to any such statements. For additional details on our reported results, please refer to the earnings press release, earnings call presentation and the Excel-based financial data workbook posted on our investor relations website. We will post these prepared remarks on our investor relations website following the completion of this call. With that, I'll now turn the call over to Eugene Scherbakov.

Eugene Scherbakov:

Good morning everyone. We are pleased with our results this quarter as we continue to diversify our revenue across key regions and applications. Second quarter revenue increased 1% year over year, but was meaningfully impacted by the strength of the U.S. Dollar which reduced revenue and revenue growth by $18 million and 5%, respectively. I am proud that we continue to make progress on our key strategies. First, we made progress to achieve a better geographic balances in our business. Sales outside of China accounted for 64% of total revenue and grew significantly this quarter led by a strong revenue growth in North America and Japan. Second, we also made progress in diversifying across different applications with record revenue in welding and strong growth in medical applications. As a result, the high power cutting business in China contributed less than 10% of IPG's total revenue in the quarter.

This was another record quarter for welding revenue that benefited from growth in electric vehicle batteries, general manufacturing, medical device applications and the adoption of our handheld laser for manual welding applications. Laser welding adoption continues as our fiber laser enables faster, more precise welding for a wide range of materials, including thin foils and highly reflective materials like copper and aluminum. Our adjustable mode beam lasers provide spatterless, high-quality, high-speed and uniform welding for a broad range of different materials used in electric vehicle battery manufacturing and other applications. Our LightWELD handheld welder is a superior tool for small and mid-size fabricators that brings ease of use to the welding process. Welding was the strongest driver behind our growth this quarter and the revenue from this application has become as important as our revenue from high power cutting applications. While our cutting business still accounted for a significant portion of IPG's revenue, welding revenue has surpassed high power cutting revenue in several key geographies.

IPG is benefiting from current investment in e-mobility, which may potentially accelerate in the near future as a result of higher energy costs across many regions. The EV market continues to drive our demand with new model launches and additional battery capacity announcements to support higher EV sales. We had record sales to EV applications in the quarter with strong demand for our welding and foil cutting solutions. We are also working on a number of additional opportunities, including cleaning and hairpin welding solutions that increase our exposure to this growing market.

Emerging growth product sales were 40% of our total revenue in the second quarter. Many of these products are benefiting from global macro trends such as automation and e-mobility as well as focus on sustainability, renewable energy and energy efficiency. More specifically, record sales in AMB lasers and high power pulsed lasers were driven by strong growth in electric vehicle applications. We saw continued sequential improvement in demand for our green lasers for solar cell manufacturing applications. This market is expected to grow as a result of increasing investments in renewable energy solutions. We also saw strong performance in cleaning applications, which is driven in part by the sustainability benefits of lasers, which help to reduce use of toxic materials. Medical revenue more than doubled year over year as our thulium laser is considered the new gold standard for the laser urology market and has been rapidly gaining adoptions. LightWELD sales increased significantly and we have received CE marking and are now selling LightWELD in several markets in Europe. We are also seeing growth in laser-based systems sales, which are benefiting from complete solutions designed for EV applications and other emerging applications such as laser cleaning.

Before I turn the call to Tim, let me provide an update on our operations in Russia.

As previously announced, IPG stopped all new investments in Russia and prepared plans to increase manufacturing of critical components in the United States and Western Europe in order to reduce our reliance on manufacturing capacity in Russia. We continue to make progress with hiring additional employees, allocating workspace for increased production and running second and even third shifts in certain locations. Our inventories of critical components increased and further lowered our risks of supply chain disruptions. We qualified some third-party suppliers and are now placing orders for some of these components. In the second quarter, we started setting up infrastructure for production increases in Germany, Italy and United States. We expect that most of the manufacturing capacity will be brought online during the course of the rest of the year enabling us to reduce our reliance on Russian components by year-end. While our facilities are moving towards ramping up production, our ability to hire additional employees remains challenging. However, we are introducing new production technologies and automation, which should eliminate some more labor-intensive steps and increase yields and productivity.

I'll turn the call over to Tim to discuss financial highlights in the quarter.

Tim Mammen:

Thank you Eugene, and good morning everyone. My comments generally will follow the earnings call presentation which is available on our investor relations website. I will start with the financial review on slide 4.

Revenue in the first quarter was $377 million, up 1% year over year driven by growth in most of our key geographies, and increased 2% sequentially mainly due to higher revenue in North America, China and Japan. Revenue from materials processing applications decreased 1% year over year and revenue from other applications increased 29%.

Second quarter GAAP gross margin was 45.7%, a decrease of 290 basis points year over year, due to increased inventory reserves as well as higher shipping costs and tariffs. We also had slightly lower absorption of manufacturing costs in the quarter which negatively impacted gross margins. This was partially offset by lower costs of product sold, which benefited from stable selling prices, lower cost products introduced to the market such as the ultra-compact lasers and improved systems' margins.

We faced strong currency headwinds this quarter with significant strength of the U.S. Dollar. If exchange rates relative to the U.S. Dollar had been the same as one year ago, we would have expected revenue to be $18 million higher and gross profit to be $10 million higher.

Excluding foreign currency transaction losses related to revaluing foreign currency assets and liabilities to period-end exchange rates, operating expenses decreased slightly year over year, primarily in research and development.

GAAP operating income was $72 million and operating margin was 19.0%. Net income was $57 million, or $1.10 per diluted share. The effective tax rate in the quarter was 22%.

During the quarter, we recognized a foreign exchange transaction losses of $18 million or 0.28 per share, primarily related to the appreciation of U.S. Dollar and Russian Ruble.

Moving to slide 5. Sales of high power CW lasers decreased 14% and represented approximately 43% of total revenue. Sales of ultra-high power lasers above 6 kW represented 50% of total high power CW laser sales. Pulsed lasers sales increased 13% year over year, with continued growth in high power pulsed lasers used in EV battery manufacturing, but offset by lower sales into solar cell manufacturing. Systems sales increased 30% year over year driven by growth in laser systems and higher sales of LightWELD. Medium power laser sales increased 4% while QCW laser sales were down 9% year over year. Other product sales increased driven by higher sales in medical applications.

Looking at our performance by region on slide 6, revenue in North America increased 33% driven by growth in cutting, welding and medical applications.

In Europe, sales increased 2% as a result of higher demand in marking, cleaning and medical applications. In the first quarter, we reported pull forward of demand in Europe as customers were securing supply, which negatively impacted demand in the second quarter.

Revenue in China decreased 14% year over year despite strong growth in welding and foil cutting applications in the region. While revenue in high power cutting applications stabilized at a lower level in the last several quarters, it was still down significantly on a year-over-year basis.

Moving to a summary of our balance sheet on slide 7, we ended the quarter with cash, cash equivalents, and short-term investments of $1.2 billion and total debt of $32 million. Cash provided by operations was $79 million during the quarter and capital expenditures were $35 million in the quarter. Cash generation was negatively impacted by an increase in inventory during the quarter as we continued to build safety stock in order to keep reasonable lead times

and secure critical components. In the second quarter, approximately $40 million of the $72 million increase in inventory value was due to the translation effect of exchange rates, with $32 million attributable to investment in inventories of critical components.

While continuing to maintain a strong balance sheet, we have returned a significant amount of capital to shareholders with our ongoing stock repurchases. In the last 18 months, IPG repurchased shares for approximately $450 million with $312 million spent on share repurchases since the beginning of this year. During the quarter, we repurchased just under 2.4 million shares for a total of $233 million, a record quarterly share repurchase number for the company. We believe in a disciplined approach to share repurchases and have become more active as the share price declined in the recent quarter, providing a good buying opportunity. Given that we completed both May 2020 and February 2022 share repurchase authorizations during the quarter, the Board approved a new $300 million share repurchase authorization in July.

Moving to outlook on slide 9, second quarter book-to-bill was slightly below 1. We saw some moderation of order flow across Europe as compared to record bookings in the first quarter, but we were pleased to see continued strength in key applications and more stable demand in other key geographies. Macroeconomic indicators have been moderating, particularly in Europe, but remained in the expansionary territory for North America and Asia. Furthermore, PMI in China returned to growth in June due to easing COVID-19 restrictions and posted a modest increase in July. While forecasting our business continues to be challenging in the medium term and our third quarter guidance remains subject to significant uncertainties, including the impact on the global business environment from geopolitical events, trade restrictions and sanctions, COVID-19, economic trends, tariffs, currency fluctuations, growth from emerging product revenue, competition and the lack of long-term binding order commitments, we continue to

benefit from growth opportunities created by major macro trends that drive growth in electric vehicle battery manufacturing applications, LightWELD and medical sales.

For the third quarter of 2022, IPG expects revenue of $350 to $380 million. The Company expects the third quarter tax rate to be approximately 25%. IPG anticipates delivering earnings per diluted share in the range of $1.00 to $1.30, with 51 million diluted common shares outstanding. We continue to expect currency headwinds and estimate that third quarter revenue guidance range is reduced by about $15 million due to the strength of the U.S. Dollar.

As discussed in the "Safe Harbor" passage of today's earnings press release, our guidance is based upon current market conditions and expectations, assumes exchange rates referenced in our earnings press release, and is subject to risks outlined in the company's reports with the SEC.

With that, we will be happy to take your questions.

Eugene Fedotoff:

Thank you for joining us this morning and for your continued interest in IPG. We will be participating in a number of investor events this quarter and are looking forward to speaking with you over the coming weeks. Have a great day everyone.